# THE NECESSITY FOR A CENTRAL BANK[1]

GEORGE E. ROBERTS

Director of the Mint

THERE is no great difficulty in locating the weakness of our banking system. Like every advanced country, we do our business very largely by the means of bank credits, and, notwithstanding the abundant resources of the country, notwithstanding the ample assets of the banks themselves, we have no means of supporting these bank credits in times of strain, or even giving them the elasticity required to meet the ordinary fluctuations of business.

According to the last report of the comptroller of the currency we had at the time it was compiled $14,000,000,000 of individual deposits in the banks of the United States and only about $1,400,000,000 of cash in the banks, or about one dollar in cash for each ten dollars of practically demand liabilities. And this ought to be cash enough. This margin of 10% is as much capital as needs to be tied up in reserves. The trouble is that it is not used to the best advantage.

This fund of cash is so divided and scattered that all confidence in its effective use is lost and its value for the support of our credits is frittered away. It is as though an army appointed to defend a city should be divided up with a certain number of men on each block, without organization or common commanders, each squad unable to give support elsewhere. When a crisis threatens, the system pulls apart and breaks down by its own efforts for self-protection, and that just at the time when it should be a source of strength and support to the business community.

It is useless in planning for the future to expect that the average banker will materially change the policy upon which he

[1] An address delivered at the anniversary dinner of the Academy of Political Science, November 11, 1910.

conducts his business. There are over twenty thousand independent banking institutions in this country, and competition fixes within narrow limits the conditions under which the business must be carried on. Competition is so keen, the banks pay so much interest on deposits, and do business under such a burden of expenses that they are practically compelled to keep their funds closely employed. There is no adequate reserve free to take care of exceptional demands or even to care for the ordinary seasonal fluctuations. We need more money and more bank credit in the last three months of each year than in any other season, but no one who is in this competitive circle can afford to keep capital idle for nine months in order to use it the other three, particularly if he is paying interest on it. It is because of this narrow margin of reserves that money so easily becomes uncomfortably tight. When the banks of the central-reserve cities have an average reserve of 26 % money is easy, and when it gets down to 24½ % money is tight.

We are just closing a year of much anxiety over banking conditions. Last spring it was reported that the banks were badly over-loaned and much apprehension was felt as to how they would come through the fall. And yet the difference between their cash reserves last spring and the spring before was a very small percentage of their liabilities.

The final banking reserve of the national system is held by the three central-reserve cities, which are required by law to carry cash reserves of 25 %. Their figures for the spring statements of 1909 and 1910 were as follows:

| | *1909* | *1910* |
|---|---|---|
| New York | 25.68 | 25.76 |
| Chicago | 26.16 | 23.35 |
| St. Louis | 25.44 | 22.36 |

The cash reserves of the reserve-city banks and country banks did not vary in greater proportions.

In the last ten calendar years, including 1910, there have been 49 officially-published statements of the condition of national banks. There were but 14 statements in which the central-reserve banks averaged above 26 % and only six in which the

average was above 27 %. It was pointed out last spring with some alarm that the loans and discounts of the national banking system were higher than they had ever been before, but the fact is that there have been but five published statements in the last ten years which do not show the loans and discounts higher than they had ever been before. They are up to the limit practically all the time. We never have any surplus reserves worth mentioning. We never have any considerable margin of unused bank credit. Come what may, we never have any important reduction of the volume of loans. Under all the stress of panic in 1907 and the depression of business that followed, the national banks as a whole succeeded in reducing their loans only about 5 %. There was considerable shifting of loans among the banks, but not much reduction in the aggregate.

The truth is that in practise our bankers have only a very limited control over the volume of their loans. They find themselves obliged to take care of their responsible customers whose accounts are desirable or see them go elsewhere, and with this country developing and business expanding, as is always the case, their loans keep up close to their available resources. It is not the fault of the individual bankers; it is inevitable under the system; it is in the lack of a central reserve fund outside the competitive circle. In other countries the responsibility of carrying adequate reserves is definitely fixed upon a great central organization and it is given special powers to deal with the task.

Fortunately, we have in the United States a great store of gold that may be used to create a fund of credit. On the first day of this month the United States treasury held $900,000,000 against the same amount of gold certificates. This is the greatest and the most ineffective gold reserve in the world. I invite your attention to the difference between the usefulness of this reserve and the next largest in the world, that of the Bank of France. Both are acquired in the same way. When gold is imported into France it goes into the bank in exchange for its notes; when gold is imported or produced in the United States it goes into the treasury in exchange for certificates. The public everywhere prefers paper to coin and an institution

that is given the sole power to issue notes against gold becomes the natural custodian of the country's stock of gold. The notes of the Bank of France come very near to being gold certificates. 70 % of the outstanding circulation of the Bank of France is covered by gold, and over 80 % is covered by gold and silver. But although the note circulation of the bank varies but little from the metallic stock, the fact that it is flexible and adaptable to the needs of the country for currency, enables that metallic stock to afford complete protection to the entire credit system of France. On the other hand the fact that our gold certificates are simply warehouse receipts prevents our $900,000,000 from being used as a central fund for credit at all.

We have this store of gold, and upon it can be built an institution as powerful for the protection of American credit as the Bank of France has been for the protection of French credit. To accomplish this end the gold must be removed from the treasury to the possession of a responsible organization over which the government and the banking system of the country have joint control. Let the notes of such an institution be made good for all the purposes for which gold certificates are now good, and be put into circulation in exchange and substitution for gold certificates. This will bring the new institution into possession of the treasury certificates, and as they are received they may be presented for redemption. By this process the gold reserve of $900,000,000 will be transferred from the treasury to the new organization. With $900,000,000 of gold in its vaults and $900,000,000 of notes outstanding it will be able in its discretion to issue say $450,000,000 of additional notes and still have a reserve of 67 %, and the ability to do this will afford ample protection to the banking and business situation in this country. In short, the transfer of ownership and control from the thousands of scattered holders of gold certificates to one representative, responsible organization will endow this reserve, now inert and useless, with all the potency and effectiveness that have always belonged to the reserves of the Bank of France.

Such an institution, although analogous in some respects to the Bank of France, need not be like it in all respects. It need not receive deposits from individuals or even from banks. The

deposits of the Bank of France amount in all to only about $140,000,000, including the government funds. The ability of the bank to protect the credit situation is not derived from its deposits, but from its stock of gold and its powers of note issue.

The main purpose with us in securing a central institution is to consolidate our gold reserve in responsible hands where it can be used to safeguard the entire banking situation. Another important function, however, would be that of serving as the fiscal agent of the treasury and handling the public funds. There is no responsibility that involves the secretary of the treasury in more annoyance and criticism than the arbitrary distribution of surplus revenues among the national banks. There is no feature of the situation that is more objectionable than this, and all the other plans for currency reform are defective in that they leave the relations of the treasury to the banks unchanged.

It not only is not necessary to have the central institution hold the reserves of the local banks over the country, but it is not desirable to have any such concentration of loanable funds. They have a more widespread and natural distribution now. It is not desirable to force any important displacement of funds or to disturb the relationships that now exist between the country banks and their city correspondents.

It is not necessary or desirable that the country banks desiring to rediscount paper should generally apply direct to the central bank. It would be better for them to get such accommodations from their regular city correspondents with whom they have daily interchange of business, to whom they are more intimately known and from whom they would perhaps be able to borrow under more flexible rules. The essential thing is that the several hundred banks of the reserve-city class shall always be able to get help when they need it. If they get it, competition will compel them to pass it on to their customers. These reserve-city banks will serve as channels through which the central reserve fund will be reached from all sections of the country.

It is not necessary to retire the outstanding bond-secured circulation of the national banks, although it would be desirable that government bonds in the future be placed on an investment

basis. There are serious objections to depriving the outstanding government bonds of the circulation privilege, and it would not be desirable to have to fill the vacuum that would be created by the retirement of $700,000,000 of bank notes.

It is not necessary to retire the United States notes. The aggregate of these notes and silver certificates outstanding in denominations above ten dollars is now less than $100,000,000 and steadily diminishing. The United States notes and silver dollars represent past mistakes; we would not provide for them if we were planning an ideal system, but they are no longer a menace to the treasury and need not be dealt with now.

It is unnecessary, in order to have a central note-issuing institution, to begin with an elaborate and complete organization. On the contrary, it would be a mistake to burden it with heavy expenses at first. It should be allowed time to develop its full functions and to articulate itself with the banking system by growth. The plan should be fundamentally sound, however, adaptable to expansion and to all the functions and responsibilities that may come to such an institution. It seems to me, therefore, that instead of being a mere advisory or administrative board, on the clearing-house plan, it should be a distinct and independent entity, able to do business on its own responsibility. A permanent institution that is to lend credit should have a paid-up capital of its own and accumulate a surplus beside, instead of doing business on the assessment plan, and certainly it is stating a primary truth to say that an institution which is to issue the paper currency of the country should have a gold reserve. I cannot conceive of such an institution playing its full part in the protection of the country's gold reserve and of the national credit without either capital or reserves of its own.

The central institution should be planned to unify and strengthen and supplement the existing banking system. While the government should have intimate supervisory relations to it, the active direction of its affairs should be in the hands of representative bankers from all sections of the country. One member from each of the thirty clearing houses leading in volume of clearings would give an admirable organization. There is no more reason to suppose that such a body, elected from all sec-

tions and drawn from both political parties, would become involved in partisan politics than there is to expect our clearing houses to become involved in politics. It is impossible, moreover, to believe that a body of men thus selected to serve in a representative capacity, personally identified with the localities from which they come and discharging their responsibilities under the scrutiny of the whole financial world, would permit the institution to be used to serve sectional and private ends. There is little in the history of such trusts, in this or other countries, to warrant such suspicion. Experience has shown that where responsibility can be definitely fixed and surrounded by full publicity, large powers may be safely granted.

There is little reason to apprehend that under such management the resources of the institution would ever be loaned to support stock-market operations, but that evil could be effectually guarded against by a proviso in the law that no part of the note issues should ever be based upon anything but gold and short-time commercial paper. An institution that could always be relied upon to take current commercial paper bearing well-rated names from the local banks of the country and give lawful money for it, would not only afford protection against panic but would enlarge the market for that class of paper and give greater mobility to our banking capital.

The objection that a central organization of this kind would create a centralized power and that this power might be abused is raised at every step in the higher organization of society. It is impossible to create any new powers, no matter how necessary or beneficial, without at least a theoretical possibility that those powers may be abused. But as population increases, as civilization develops, and as society becomes more interdependent, we are bound constantly to provide a higher and more complex organization. The beginnings of our political organization were in the old town meeting of New England, but whether we like all the performances of our state and national governments or not, it is certain that we cannot govern a nation like the United States with nothing but town meetings. Before we had any railways we had no need for an interstate commerce commission, a body to which we have now confided a very high degree

of centralized control. The whole problem of railway control is incidental to our industrial and social progress.

Finally, a system of thousands of scattered and unrelated banking institutions is unequal to the responsibilities which in a country of such vast industrial and commercial interests as ours are necessarily laid upon the banking system. A higher organization of our banking power is absolutely required and somehow it will be supplied. There are going to be great central banking institutions in this country whether we make special provision for them or not. The banking business is not going to stand still while development goes on in all other lines. Unification and organization will go on in the banking business as elsewhere; the question is, shall we recognize the tendency and the necessity for it, shall we shape its development, shall we supply the means to make it most effective and serviceable, shall we keep our hands on it and regulate it, or shall we permit it to develop without direction or control?